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CONFINDUSTRIA

CONFINDUSTRIA reply to the consultation on the revision of the EU ETS Directive

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Position Paper

1. Free allocation and addressing the risk of carbon leakage

1.1 The European Council called for a periodic revision of benchmarks in line with technological progress. How could this be best achieved in your view and, in particular, which data could be used to this end? How frequently should benchmarks be updated, keeping in mind administrative feasibility?

The European Council conclusions of October 2014 have clearly stated that carbon leakage measures should continue after 2020 as long as there are no comparable efforts to reduce emissions in other major economies. They have also set out a number of **key competitiveness principles** that should guide the definition of carbon leakage measures post-2020. CONFINDUSTRIA believes that it is of utmost importance that these principles are properly interpreted and translated into **effective legislation** in order to provide a strong protection for exposed industry.

The allocation of free allowances should continue to be based on EU-wide harmonized product benchmarks. These benchmarks will have to be **realistic** for industry, meaning that they have to be **economically and technologically achievable**. To this aim, benchmarks should be defined through a **bottom up approach** with the full involvement of stakeholders.

The benchmarks should be set **ex-ante before each trading period**. In order to provide reasonable long-term predictability for industry, there should be **no revision of the benchmark within the trading period**. All revision should be carried out in close cooperation with installation operators.

The current criteria for the definition of the benchmark (the average 10% of best performers within each sector) should be maintained in the post-2020 framework.

1.2 The European Council has defined guiding principles for the development of post-2020 free allocation rules which provide inter alia that "both direct and indirect costs will be taken into account, in line with the EU state aid rules" and that "the most efficient installations in these sectors should not face undue carbon costs leading to carbon leakage" while "incentives for industry to innovate will be fully

preserved and administrative complexity will not be increased" and while "ensuring affordable energy prices". Do you have views how these principles should be reflected in the future free allocation rules?

The **best performing installations** within the related benchmark should receive 100% of free allowances.

No C-factor should be applied, as it reduces the number of allowances that the sectors exposed to carbon leakage are entitled to receive.

As stated in the European Council conclusions, both direct and indirect costs need to be compensated, without prioritising one against the other, given their equal importance for industrial competitiveness.

The **compensation of indirect costs** (occurring from the pass-through cost of carbon into the electricity price) needs to **be harmonised at EU level by replacing the current discretionary state aid rules** with a new mechanism.

The current framework only sets maximum compensation levels allowed through state aids guidelines for a list of industrial sectors and it is discretionary for each Member State to give this compensation. Therefore, the state aid guidelines have generated **significant competition distortions** among Member states in the third trading period.

Specific mechanisms, such as the use of auctioning revenues or additional free allocation, should be put in place instead of regulating the issue through state aids rules.

The definition of eligible sectors should be defined according to electro-intensive sectors and/or installations as defined in the Environmental and Energy Aid Guidelines (EEAG) using the combination of trade intensity and electro intensity.

It is therefore necessary to **set mandatory EU compensation measures, establish a harmonised approach and review the list of eligible sectors.**

The **level of free allowances** should be determined by using **activity levels from most recent years**. There are several reasons why the mechanism needs to be changed.

The current ex-ante mechanism based on **historical production**, coupled with the C-factor, does not provide for effective protection for best performers in each sector.

A **more flexible and dynamic allocation mechanism** reflecting the most recent production will avoid over/under-allocation and will not penalize companies' growing perspectives.

The use of an **allocation mechanism adjusting the free allocation to actual production levels** will also allow to avoid the regulatory burden of closure rules and procedures since there will be no "over allocation" due to reduced activity. This will address the carbon leakage risk whilst preserving the incentive for industry to innovate.

In case of **fall-back approach**, full free allocation should apply for process emissions, since these emissions are irreducible and cannot be improved by economically viable technological means, such as energy efficiency measures.

Only ensuring ALL the above conditions, the best performing installations will not have to face "undue carbon costs leading to carbon leakage", as specifically requested by the European Council in October 2014 conclusions.

1.3 Should free allocation be given from 2021 to 2030 to compensate those carbon costs which sectors pass through to customers? How could free allocation be best determined in order to avoid windfall profits?

The question is not clear. A sector deemed to be exposed to the risk of carbon leakage is, by definition, presumably not able to pass CO₂-related direct and indirect costs through to consumers without losing market shares with regard to extra-EU competitors.

However, an **allocation method better aligned to changing production levels** can avoid windfall profits. Using actual production or a rolling production level as the basis for allocation/compensation would eliminate the risk of windfall profits for industry receiving free allocation.

Power utilities falling under derogation art. 10.c should be carefully monitored in the implementation of agreed national investments plans ('national plans'). A periodic assessment of progress made by derogated Member States in retrofitting and upgrading infrastructures, in clean technologies and in diversifying their energy mix and sources of supply should be implemented with the possibility to revoke the derogation in case of a negative outcome.

1.4 Are there any complementary aspects you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?

The European Council conclusions stated very clearly that measures to provide appropriate levels of support for sectors at risk of losing international competitiveness due to climate policy should be maintained as long as **no comparable efforts** are undertaken in other major economies. The EU accounts for 9% of global emissions and this share is falling, while emissions will be growing outside Europe. The EU is still the only largest economy having adopted a binding regulation that has imposed a cap on its industry emissions. Therefore, the issue of **comparability of efforts** is crucial to assess the **future competitiveness of European industry**. As long as **global industry competitors** are not subject to the same **binding emissions reduction targets**, CO₂-related direct and indirect costs remain a critical challenge for **EU industry growth, jobs and investments**. Current carbon leakage measures need to be **strengthened through a stable long-term framework** putting in place the most effective instruments.

Furthermore, climate policy needs a broader approach which also takes into account embedded emissions in imported products. Therefore, the **inclusion of imports in the trading scheme** also deserves an in-depth assessment in order to ensure that the EU is not simply decarbonising by deindustrialising.

2. Innovation Fund

2.1 Do you see reasons to modify the existing modalities applied in the first two calls of the NER300? Are there any modalities governing the NER 300 programme which could be simplified in the design of the innovation fund? If you see the need for changes, please be specific what aspects you would like to see changed and why.

ETS revenue recycling is a good principle to be promoted within the ongoing ETS revision. The most important feature to be preserved of the NER 300 Programme refers to its **national setting** (calls and awards at Member States' level) which enables to better take into account national circumstances and allow operators to integrate financing sources coming from the Programme with other EU Funds.

Direct redistribution of revenues to operators should be promoted to simplify the funding process by shortening awarding procedures and reducing administrative burdens for participants.

The share of the post-2020 allowance budget should be substantially higher than in phase 3 to support R&D in climate efficient investments at the European level. This would be consistent with Council Conclusion of October 2014.

The administrative burden for project application should be reduced and the decision procedures for granting support must be faster and much more efficient to avoid insecurities and delays for operators.

Simplification and harmonization of permitting procedures at EU and national level is necessary.

2.2 Do you consider that for the extended scope of supporting low-carbon innovation in industrial sectors the modalities should be the same as for CCS and innovative renewable energy technologies or is certain tailoring needed, e.g. pre-defined amounts, specific selection criteria? If possible, please provide specific examples of tailored modalities.

The EU ETS should **not be the only instrument** to finance low-carbon innovation in industrial sectors. The ETS was primarily designed as a contribution to cost-effective reduction of GHG emissions.

However, **all ETS auctioning revenues** must be used more effectively and efficiently and assist the decarbonisation of European industry without impairing its international competitiveness. Supporting **low-carbon innovation in industrial sectors** could be funded through a new dedicated scheme financed by the revenues from auctioning (e.g. x% of the auctioning revenues).

Low-carbon innovation initiatives in industrial sectors should be tailored to macro sectors in order to spur technological innovation and efficiency improvements (e.g. EAF steel production). Tailoring would be needed to target specific technology customers. Technologies with similar characteristics should be clustered together and encouraged to compete.

Eligibility criteria should not be based on minimum size thresholds, as this would discriminate against SMEs and funding thresholds should be at an appropriate level to support small-scale demonstration projects, not just large commercial schemes. Furthermore, considering the high level of risk associated with developing unproven technologies, an increase in the current level of co-funding (50%) should be assessed.

2.3 Are there any complementary aspects regarding innovation funding you would like to add to the replies given to the previous written consultation in the light of the European Council conclusions?

An allowances-based financing represents an option to be further explored. Possible extra free allocation conditional upon low carbon investments should be further explored.

5. SMEs / regulatory fees / other

5.1 Are there any EU ETS administrative requirements which you consider can be simplified? Do you see scope to reduce transaction costs, in particular for SMEs? If yes, please explain in detail.

As stated in the European Council conclusions, the EU ETS administrative requirements need to be **substantially reduced and simplified**. Current compliance requirements for companies are particularly burdensome with regard to emissions monitoring, verification and communication. The most complex administrative burden is related to the repeated communication to the competent authority of any changes related to monitoring plans, activity levels, changes in the plant structure, authorised sources etc. These communication requirements could be significantly reduced or simplified without impairing the correct functioning of the system.

The **current administrative complexity** is partially due to the need to communicate any changes related to the ex-ante historical emissions data (i.e. partial cessation, complex rules for new entrants).

For these reasons, **an allocation mechanism based on actual production** would reduce the administrative burden, rather than increase it.

Monitoring and reporting rules represent a major component of the administrative burden for ETS installations and SMEs in particular.

A disproportionate amount of effort is currently required to monitor, report and verify the emissions from de-minimis source streams. Consequently de-minimis sources of emissions should be completely excluded from the monitoring and reporting obligations.

Another very important change, with great simplification potential is the reduction of the number of low emissions sites (see reply 5.2).

5.2 Member States had the possibility to exclude small emitting installations from the EU ETS until 2020. Should this possibility be continued? If so, what should be the modalities for opt-out installations to contribute to emission reductions in a cost-effective and economically efficient manner? Should these be harmonised at EU level?

The possibility to exclude small emitters should be continued after 2020.

More generally, with the aim to improve the cost-effectiveness of the ETS scope, it would be useful to assess the opportunity of directly excluding installations which cover a very small portion of overall emissions.

In line with the new Commission's objective of reducing EU bureaucracy and focusing only on bigger priorities, the opt-out possibility should be extended to installations with annual emissions below 50.000 tons.

As by a study carried out by the EEA in 2013, the exclusion of 40% of installations would account only for 2% of regulated emissions, while the exclusion of installations with reported emissions below 50.000 tons occur to 75% of installations would account for 5% of regulated emissions. (95 million tonnes vs. 1.75 billion tonnes).

One of these options would eliminate an unjustifiable excessive administrative burden on sites with a negligible contribution to regulated GHG emissions.

5.3 How do you rate the importance of a high level of security and user-friendliness of the Union Registry? Do you think the costs for providing these services should be covered via Registry fees?

There is substantial scope for increasing the level of security and the friendliness of the Registry in order to cut red tape. Any software update should be financed by Member States rather than by the users.

The costs should be financed through a specific fee.

5.4 Do you consider discrepancies in Registry fees in different Member States justified? Should Registry fees be aligned at EU level?

The Commission should assess the benefits/disadvantages of having a EU harmonised fee vs. fees set at national level.

5..5 Under the current EU ETS Directive, at least 50% of the revenues generated from the auctioning of allowances should be used by Member States for climate-related purposes. For the calendar year 2013 Member States have reported to have used or to plan to use 87 % on average to support domestic investments in climate and energy. Do you consider the current provisions regarding the use of the revenues adequate for financing climate action? If not, please explain why?

The current provisions on auctioning revenues need to be **substantially revised**.

Revenues are generated by ETS incumbents. Therefore, to the benefit of the overall effectiveness and efficiency of the system, **100% of revenues must be reinvested for ETS/climate purposes only**, including measures for shielding ETS industry from **undue CO2 related direct and indirect costs**, as specified in the answers provided to Q 1.1 and 1.2 above. (i.e. free allowances and compensation for indirect costs).

The current provisions, which leave wide margins to Member States to decide the use of auctioning revenues, is creating **significant distortions in the internal market, while distracting important resources** generated by a regulatory framework (EU ETS) from the specific aims for which such framework has been set up.

6. General evaluation

6.1 How well do the objectives of the EU ETS Directive correspond to the EU climate policy objectives? How well is the EU ETS Directive adapted to subsequent technological or scientific changes?

The EU ETS Directive corresponds to EU climate objectives, as it will be the main instrument to meet the 40% emissions reduction target set for 2030. The main contribution to achieving this target will be provided by industry reducing its emissions by 43% on 2005 levels. It is worth reminding that, as too often is the case, the 2005 reference as baseline for the 2030 emissions reduction target penalises early action.

However, since **climate change is a global issue** and needs to be tackled at global level, achieving the EU climate policy objectives will not be enough for fighting against climate change. For this, the EU needs to convince all global major emitters to sign a binding global agreement which sets **binding comparable efforts on competing industries**. In the absence of such an agreement, the EU climate objectives must be

accompanied by **effective competitiveness measures**, as already described above.

By establishing **benchmarks** that are economically and technologically achievable by industry, the EU ETS is well adapted to respond to technological scientific change. Achieving such benchmarks and therefore reducing CO₂ costs will be the main driver for innovation in industry.

6.2 What are the strengths and weaknesses of the EU ETS Directive? To what extent has the EU ETS Directive been successful in achieving its objectives to promote emission reductions in a cost-effective manner compared to alternatives, e.g. regulatory standards, taxation?

The EU ETS is a cost-effective, technology-neutral harmonised system. As long as it remains a **market-driven mechanism** and is not steered by political interference, it is preferable to alternative instruments such as national emissions reduction policies.

However, the current EU ETS has a **number of major weaknesses** that need to be addressed.

Firstly, the ETS will truly ensure a **EU level playing field** only when **CO₂ indirect costs** are compensated through a EU harmonised mechanism.

Secondly, there is a need for a **comprehensive revision of the ETS**. Since the introduction of a Market Stability Reserve will **increase both direct and indirect costs**, **adequate protection for direct and indirect CO₂-related costs** incurred by industry exposed at risk of carbon leakage **should be in place as soon as the MSR is introduced**. These two measures need to be **assessed in conjunction**.

An adequate protection for industry will be ensured only by adopting (as per answers to Q 1.1 and 1.2 above) **realistic benchmarks, eliminating the C-factor, introducing a more dynamic allocation and harmonised compensations for indirect costs**.

However, only a **global agreement** ensuring **comparable efforts for competing sectors** will **prove the real effectiveness of the EU ETS** in achieving its climate objectives.

Furthermore, the ETS as a market instrument to drive carbon reduction needs a better coordination with other incentives to promote energy efficiency and renewables. Overlaps among incentive policies delivered

severe market distortions on CO₂ prices ranging from 5 Euro/T (ETS market price) to 150 Euro/T (as avoided cost measured in terms of average RES incentive scheme). In the fourth period the Union should adopt an integrated policy where the ETS would be the main driver for both energy efficiency and renewables.

6.3 To what extent are the costs resulting from the implementation of the EU ETS Directive proportionate to the results/benefits that have been achieved, including secondary impacts on financing/support mechanisms for low carbon technologies, administrative cost, employment impacts etc.? If there are significant differences in costs (or benefits) between Member States, what is causing them?

As mentioned above under Q. 5, further consideration should be given to the costs vs. benefits of the current ETS scope and to the administrative burden of the overall system.

The uneven compensation of indirect CO₂ costs due to the current state aid mechanism is creating significant differences among Member States. As of today, only six Member States have allocated resources for the compensation of indirect CO₂ costs and with wide discrepancies in terms of financial support. An **harmonised EU system** would address such distortions.

Costs related to the verification of the quality of fuels are particularly burdensome. Distances from the set parameters are extremely limited, while repeating the analyses with excessive frequency is costly and does not provide any real additional benefits.

6.4 How well does the EU ETS Directive fit with other relevant EU legislation?

To ensure that **competitiveness, security of supply and climate objectives** are better balanced than in the past, and for the **consistency of the overall framework**, the EU ETS Directive should be assessed in conjunction with all legislation relevant to the 2030 Climate and Energy Package (i.e. Energy Efficiency Directive, Renewables Directive, Effort Sharing).

Moreover, in view of a **better regulation** approach, the EU ETS should also been assessed against other EU legislation aimed at curbing industrial emissions (IED, Air Quality), with the aim to avoid overlapping and reduce cumulative administrative and economic burdens on industry.

The binding **GHG reduction target of -40%** on 1990 levels should remain the driving objective of the 2030 political framework. The 27% EU level binding renewables target and the 27% energy efficiency target should be regarded as supporting instruments for the overall GHG emissions reduction target.

Lessons learnt from the 2020 framework have shown that **multiple targets (GHG, EE, RES) have reduced the cost-effectiveness of the overall system and have increased the costs on the economy**. This approach must not be continued in the future.

One of the most inefficient aspects of the 2020 framework has been the overlapping of the EU ETS with some national RES incentive schemes. These policies have largely increased the costs of GHG reductions and, together with the ex-ante allocation method, have contributed to increase the allowances surplus. To give an example, in Italy the cost of a renewable electricity incentive policy has charged extra 50 Euro/MWh to consumers.

6.5 What is the EU value-added of the EU ETS Directive? To what extent could the changes brought by the EU ETS Directive have been achieved by national measures only?

The EU value-added is to be seen in the fact that the EU ETS is a market-based mechanism and is a EU-wide harmonised system. Care should be taken to ensure that the market mechanism aspect is not impaired by subsequent top-down legislation. National MS policies (that we unfortunately see on the rise) are counterproductive and damage the ETS system.

6.6 Do you have any other comment on the revision of the EU ETS Directive that you would like to share?

The revision of the EU ETS Directive should be carried out in conjunction with the adoption of the legislative proposal for the establishment of a Market Stability Reserve with the aim to **provide a long stable regulatory framework for industry**.

The -43% target set for industry is very ambitious and it has to be measured against the real emission reduction potential of each sector. As long as no **comparable efforts by global competing industries** are put in place, carbon leakage measures must be well-targeted and need to be defined as soon as possible to allow predictability for investments.

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The emissions reduction target for industry must not work against the EU aspirational target of increasing the contribution of manufacturing industry to EU GDP to 20% in 2020.

The main condition to allow EU industry to grow in the future must be that of **reducing the gap in energy prices** towards our global competitors, especially towards those countries of major relevance for EU competitiveness.